**DEPARTMENT OF STATE REVENUE**

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**Letter of Findings Number: 08-0027**
**Corporate Income Tax**
**For the Tax Years 2004 and 2005**

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**I. Adjusted Gross Income Tax–Nexus.**

**Authority**: IC § 6-3-2-2; 45 IAC 3.1-1-38; 45 IAC 15-5-1; 15 U.S.C. § 381; *Wabash, Inc. v. Dep't. of State Revenue,* 729 N.E.2d 620 (Ind. Tax Ct. 2000); *Wisconsin Dep't. of Revenue v. William Wrigley, Jr.,* 505 U.S. 214, 112 S. Ct. 2447 (1992).

Taxpayer protests the imposition of corporate income tax.

**II. Adjusted Gross Income Tax–Investigation Method.**

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-5-4; 45 IAC 15-5-1.

Taxpayer seeks adjustment in the assessed tax based upon Taxpayer's objections to the investigation method that was used by the Department to determine the tax base.

**III. Tax Administration–Twenty Percent Failure to File Penalty.**

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-3.

Taxpayer protests the imposition of penalty.

**STATEMENT OF FACTS**

Taxpayer is a foreign corporation. Taxpayer is a supplier of products and a provider of engineering and production services for both the manufacturers of automobiles and automobile parts and third party suppliers of those manufacturers. Taxpayer owns fifty percent of a subsidiary (hereafter "Indiana Subsidiary") that manufactures and supplies automobile parts to an automobile manufacturer. Taxpayer sold raw materials, dies, equipment, repair parts, and tooling to Indiana Subsidiary. Taxpayer's subsidiaries also paid personnel and engineering service fees for at least seven of Taxpayer's employees who visited Indiana each staying anywhere from two to six weeks at a time during the 2004 and 2005 tax years. The effect of the visits of the Taxpayer's employees was that Taxpayer had a presence in Indiana, at a minimum, from February 17, 2004, to April 27, 2004; from June 21, 2004, to September 13, 2004; and from January 14, 2005, to February 28, 2005.

Pursuant to an investigation, the Indiana Department of Revenue (Department) assessed corporate income tax, failure to file penalties, and interest for the 2004 and 2005 tax years. The Department found that Taxpayer had sufficient nexus with Indiana to subject Taxpayer to Indiana corporate income taxes for the 2004 and 2005 tax years. During the investigation, the Department sent multiple requests that Taxpayer submit Indiana adjusted gross income tax returns for the tax periods 2004 and 2005. Taxpayer did not provide the Department with returns. Since Taxpayer declined to file returns and make its books and records available to the Department, the assessments were made based upon the best information available to the Department. Taxpayer protested this imposition of tax and penalties. An administrative hearing was held, and this Letter of Findings results.

**I. Adjusted Gross Income Tax–Nexus.**

**DISCUSSION**

The Department found that Taxpayer had sufficient nexus with Indiana to subject Taxpayer to Indiana corporate income taxes for the 2004 and 2005 tax years and issued assessments based upon the best information available to the Department as prescribed by 45 IAC 15-5-1.

Taxpayer protests the imposition of corporate income taxes for the 2004 and 2005 tax years. Taxpayer asserts that the Department has not established that Taxpayer had nexus for the years at issue.

The adjusted gross income tax is imposed under IC § 6-3-2-2, which provides, in relevant part:

(a) With regard to corporations and nonresident persons, "adjusted gross income derived from sources within Indiana", for the purposes of this article, shall mean and include:

(1) income from real or tangible personal property located in this state;
(2) income from doing business in this state;
(3) income from a trade or profession conducted in this state;
(4) compensation for labor or services rendered within this state; an
(5) income from stocks, bonds, notes, bank deposits, patents, copyrights, secret processes and formulas, good will, trademarks, trade brands, franchises, and other intangible personal property if the receipt from the intangible is attributable to Indiana under section 2.2 of this chapter.

In the case of nonbusiness income described in subsection (g), only so much of such income as is allocated to this state under the provisions of subsections (h) through (k) shall be deemed to be derived from sources within Indiana. In the case of business income, only so much of such income as is apportioned to this state under the provision of subsection (b) shall be deemed to be derived from sources within the state of Indiana.

In the case of compensation of a team member (as defined in section 2.7 of this chapter) only the portion of income determined to be Indiana income under section 2.7 of this chapter is considered derived from sources within Indiana. In the case of a corporation that is a life insurance company (as defined in Section 816(a) of the Internal Revenue Code) or an insurance company that is subject to tax under Section 831 of the Internal Revenue Code, only so much of the income as is apportioned to Indiana under subsection (r) is considered derived from sources within Indiana.

. . ..

Further, 45 IAC 3.1-1-38 provides:

For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:

(1) Maintenance of an office or other place of business in the state

(2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or consigned goods

(3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution

(4) *Rendering services to customers in the state*

(5) Ownership, rental or operation of a business or of property (real or personal) in the state

(6) Acceptance of orders in the state

(7) *Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income.*

As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n). (*Emphasis added.*)

Of relevance here is 15 U.S.C. § 381 (P.L. 86-272), which prohibits states from imposing a net income tax on a foreign taxpayer if the foreign taxpayer's only business activity within that state is the solicitation of sales. A state may not impose an income tax on income derived from business activities within that state unless those activities exceed the mere solicitation of sales.

The provisions outlined in regulation 45 IAC 3.1-1-38 constitute a minimum threshold of activity in which an entity must engage to warrant inclusion in the Indiana consolidated return as activity sufficient to establish nexus with the state such that taxation would not be prohibited under P.L. 86-272. The U.S. Supreme Court established that a de minimus *[sic]* amount of non-solicitation activity would not cause a corporation to lose the exemption from taxation afforded by P.L. 86-272. *Wisconsin Dept. of Revenue v. William Wrigley, Jr.,* 505 U.S. 214, 228-29, 112 S.Ct. 2447, 2456-57 (1992). The Court also stated that a company would lose the protection of P.L. 86-272 if it performs an activity that establishes a nontrivial additional connection with the taxing state. *Id.* at 231-32. The Indiana Supreme Court has stated that particular emphasis should be placed upon the totality of the business activities of a company within Indiana when interpreting P.L.86-272. *See Wabash, Inc. v. Department of State Revenue*, 729 N.E.2d 620, 624 (Ind. Tax Ct. 2000) (*citing Indiana Dept. of Revenue v. Kimberly-Clark Corp.,* 416 N.E.2d 1264, 1268, 275 Ind. 378, 383 (Ind.1981)).

During the course of the protest, Taxpayer submitted information about four of its employees' presence in Indiana. Employees one and two were present for about two weeks from February 17, 2004, to March 5, 2004; employee three was present for two and a half weeks from March 4, 2004, to March 23, 2004, and employee four was present for a little over three weeks from April 4, 2004, to April 27, 2004. In other words, Taxpayer had an employee presence in Indiana for over three months. Taxpayer submitted a statement describing the four employees' presence in Indiana, as follows:

The purpose of the visits was as follows:

1) Meet the management group that had been hired by [the Indiana Subsidiary].

2) Review the documents to establish [Indiana Subsidiary] that had been prepared by local attorneys.

3) Review the plant layout with management.

4) Review efficiency of the manufacturing process.

5) Review quality control procedures to ensure that [the Indiana Subsidiary] produced quality products.

6) Review how issues would be addressed that may result from problems encountered during the manufacturing process.

7) Overall review of [the Indiana Subsidiary's] company policies including financial reporting to [Taxpayer] and reporting of federal and state income tax returns.

These individuals were sent from the [Taxpayer's] foreign country of [residence], as representatives of [Taxpayer] to visit the [Indiana Subsidiary's] new facility and to ensure that the proper policies and procedures were in place. It was a visit designed to protect the [Taxpayer's] investment in [Indiana Subsidiary] and not as a means to sell products or services to [Indiana Subsidiary].

During the course of the protest, Taxpayer submitted information about Taxpayer's sales activity. Taxpayer described its sales activity to its Indiana Subsidiary as follows:

[Taxpayer] sold many dies and tooling parts to [Indiana Subsidiary] as well as inventory parts. The tooling

(press dies and die parts) was designed and manufactured in Japan. The items were sold FOB [Taxpayer's country of residence]. Therefore, the title to the goods shifted to [Indiana Subsidiary] in [Taxpayer's country of residence]. [Indiana Subsidiary] was responsible for all shipping costs, Customs duty, Customs surcharge and other related costs. The air freight costs are billed to [Indiana Subsidiary] by [Taxpayer], while the Customs duty and surcharges are billed to [Indiana Subsidiary] by the shipper.... Since all tooling was designed and manufactured in [Taxpayer's country of residence], and title passed to [Indiana Subsidiary] in [Taxpayer's country of residence], the engineering fees [that Taxpayer received from Indiana Subsidiary] are also not taxable in the State of Indiana.

On one hand, Taxpayer argues that because the title of the goods it sold to Indiana Subsidiary passed in the foreign country, the activities of Taxpayer did not exceed mere solicitation and are protected by P.L. 86-272. On the other hand, Taxpayer argues that its employees' activities during their several months' presence in Indiana had nothing to do with the solicitation of sales.

As stated previously, the Indiana Supreme Court stated the emphasis should be placed upon the totality of the business activities of a company within Indiana when interpreting the nexus limitations of P.L. 86-272, which prohibits the subjection of income tax based upon the mere solicitation of sales. Since Taxpayer has presented evidence that its employees' activities during their several months' presence in Indiana had nothing to do with the solicitation of sales, then Taxpayer by its own account has shown its Indiana activities fall outside the protection of P.L. 86-272. Without the protection of P.L. 86-272, Taxpayer has income tax nexus with Indiana for its sales to Indiana residents–regardless of the shipping terms–and is subject to Indiana income tax.

**FINDING**

Taxpayer's protest is respectfully denied.

**II. Adjusted Gross Income Tax– Investigation Method.**

**DISCUSSION**

During the investigation, the Department sent multiple requests for Taxpayer to submit Indiana adjusted gross income tax returns for the 2004 and 2005 tax years. However, Taxpayer did not provide the Department with returns. Therefore, the Department prepared returns for Taxpayer, based on the best information available to the Department as prescribed by 45 IAC 15-5-1.

Pursuant to IC § 6-8.1-5-1(b), "If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax due on the basis of the best information available to the department."

In Taxpayer's case, the Department believed that the "best information available" consisted of the information from Indiana Subsidiary's financial statements, the records of Indiana Subsidiary, and the "smaller business" statistics that were available from "BizStats.com." After obtaining that information, the Department fulfilled its legal responsibility to make a "proposed assessment." Indiana law provides that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is wrong." IC § 6-8.1-5-1(c).

Each taxpayer is required to maintain records sufficient to determine the amount of tax due. IC § 6-8.1-5-4(a) provides, as follows:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine that tax, including invoices, register tapes, receipts, and canceled checks.

Taxpayer failed to maintain or provide the records necessary for the Department to verify Taxpayer's corporate income tax liabilities as required under IC § 6-8.1-5-4(a). There is nothing to indicate that the Department erred in relying on the "best information available" at the time the investigation was conducted.

Taxpayer asserts that if Taxpayer has nexus with Indiana, Taxpayer has objections to the investigation method that was used by the Department to determine the tax base. Taxpayer objects to the Department's use of "BizStats.com Statistics" to determine the "percent that net income is of revenue" for adjusted gross income purposes. Additionally, Taxpayer objects to the imposition of income tax on the receipts from "fees for assigned personnel and engineering."

**A. Business Expenses: "BizStats.com Statistics."**

The Department found that based upon Taxpayer presence in Indiana, the "small business" profitability statistics provided by "BizStats.com" were the most appropriate to use to determine the "percentage of receipts that is revenue."

During the course of the protest, Taxpayer provided an estimation of its tax liabilities based upon alternate "net profit" statistics of "large corporations" that are currently available on "BizStats.com." In reviewing the Taxpayer's estimations, the Department is unable to conclude that, pursuant to, IC § 6-8.1-5-1(c), taxpayer has met his burden of demonstrating that the proposed assessments are wrong. The alternate statistics are simply Taxpayer's unsupported declarations that these estimates for "large corporations" in the United States are better than the Department's best information available assessments using the "small business" statistics. During the

course of the investigation, Taxpayer declined multiple opportunities to provide returns with the Taxpayer's actual tax information and chose instead to believe that providing these alternate estimates was sufficient to rebut the proposed assessments. Taxpayer is mistaken.

Additionally, Taxpayer points to an error on page six of the investigation report where the Department incorrectly references the "Engineering and Architectural Services" profitably statistic for the "percent that net income is of revenue" as being four and four tenths (4.4) percent instead of the 50.6 percent that is used in the calculation to determine adjusted gross income tax. Taxpayer asserts that the four and four tenths (4.4) percent is the correct number to use in the calculation. However, in reviewing the documentation that the Department used in the investigation, the 50.6 percent is the correct number in the statistic and the four and four tenths (4.4) percent referenced on the bottom of the page was a harmless error.

Therefore, Taxpayer's protest is respectfully denied.

**B. Personnel and Engineering Fees.**

The Department found that Taxpayer had Indiana income from "personnel and engineering fees" it received from Indiana Subsidiary and subjected those receipts to Indiana adjusted gross income tax. The financial statements of the Indiana Subsidiary provided that "[Indiana Subsidiary] paid fees to [Taxpayer] for assigned personnel and engineering fees totaling $213,008 and $192,817 in 2005 and 2004, respectively."

Taxpayer asserts that the "assigned personnel and engineering fees" all related to invoiced "employee travel expenses," "living expenses," and "management fees." Taxpayer maintains that all these charges were invoiced to Indiana Subsidiary as mere reimbursements of the expenses of sending its employees to visit Indiana Subsidiary and do not represent any profit that is subject to adjusted gross income tax.

During the course of the protest, Taxpayer submitted a statement comparing the annual salaries of four of its employees to the $15,000 of invoiced "management fees" charged for those employees. Taxpayer maintained that the invoiced "management fees" were based upon taking the four employees' annual salary divided by 260 days–the number of week days in a year–to get a daily fee. Thereafter, the daily fee was multiplied by the total number of days the employee was in Indiana, including weekend days.

In reviewing the Taxpayer's statement, the Department is unable to conclude that, pursuant to, IC § 6-8.1-5-1(c), taxpayer has met his burden of demonstrating that the proposed assessments are wrong. Taxpayer has provided an unsupported declaration that the $15,000 of invoiced "management fees" were reimbursements of the actual salary expense and represent a better estimate of Taxpayer's income tax liability for the "assigned personnel and engineering fees" than the Department's best information available assessments.

During the course of the investigation, Taxpayer declined multiple opportunities to provide returns with the Taxpayer's actual tax information and chose instead to believe that providing these assertions about reimbursed expenses was sufficient to rebut the proposed assessments. Taxpayer is mistaken.

Therefore, Taxpayer's protest is respectfully denied.

**FINDING**

Taxpayer's protest is respectfully denied.

**III. Tax Administration–Twenty Percent Failure to File Penalty.**

**DISCUSSION**

Taxpayer protests the imposition of the twenty percent penalty imposed upon the Department's filing of tax returns for 2004 and 2005 tax years on its behalf. This penalty is imposed pursuant to IC § 6-8.1-10-3, which provides:

> (a) If a person fails to file a return on or before the due date, the department shall send him a notice, by United States mail, stating that he has thirty (30) days from the date the notice is mailed to file the return. If the person does not file the return within the thirty (30) day period, the department may prepare a return for him, based on the best information available to the department. The department prepared return is prima facie correct.
>
> (b) If the department prepares a person's return under this section, the person is subject to a penalty of twenty percent (20%) of the unpaid tax. In the absence of fraud, the penalty imposed under this section is in place of and not in addition to the penalties imposed under any other section.

Under IC § 6-8.1-5-1(c), "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Since Taxpayer has failed to produce any documentation that demonstrates that the Department's assessment of the penalty for its failure to file was incorrect, Taxpayer has failed to meet its burden.

**FINDING**

Taxpayer's protest is respectfully denied.

**CONCLUSION**

In summary, Taxpayer's protest is denied.

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